

### **CHANGING THE WAY WE BUDGET**

The world is changing – and state government must change with it. Families are budgeting differently as they adjust expectations. Businesses both large and small feel it too. States all across the country are facing a new reality. How we plan, how we spend, and how we prepare for our long-term future must change.

Just as businesses embrace new methods, models, and technologies, so too must state government. That's why Governor Malloy has proposed changes to improve and stabilize our fiscal future based on five principles:

#### PRINCIPLE #1 – LIMIT SPENDING TO AVAILABLE RESOURCES BY REFORMING CURRENT SERVICES

- We cannot budget from a position that expects revenue increases year after year. We should budget based on the revenue we expect to take in.
- We should move towards a system similar to zero-based budgeting. Just as households budget based on what they have not on what they wish they could spend so too must Connecticut.

#### PRINCIPLE #2 – TACKLE OUR LONG-TERM PENSION OBLIGATIONS

• For years, Connecticut failed to save for its retired workers and now our state has one of the worst funded pension systems in the nation. The state faces a fiscal cliff in 2032, and we need to move forward to flatten out and manage the payments in a strategic way.

#### PRINCIPLE #3 - DEFINE AND PRIORITIZE CORE GOVERNMENT SERVICES

• We must define our "core services" and prioritize how to best serve Connecticut residents. Core services cannot comprise every single line item.

#### PRINCIPLE #4 - HOLD STATE AGENCIES ACCOUNTABLE FOR RESULTS

Agency commissioners should focus on performance, outcomes, and cost-effectiveness. Without
flexibility, Commissioners can't do the job we expect. By changing our current approach and adding
technological tools aimed at increasing transparency, we can move Connecticut forward.

#### PRINCIPLE #5 – USE A TRANSPARENT, BIPARTISAN PROCESS

• The Governor firmly believes that by changing *how* we come to a budget bill, we can improve the final result. We welcome anyone to that table – Democrat or Republican.

### **How Connecticut Currently Budgets**

"Current services" is based on an expectation of ever-growing spending. Currently, the starting point for our budgets are built on what we hope to be able to spend – not on the revenue we expect to collect – because it assumes that all expenditures, once budgeted, should continue forever.

For many years, the state of Connecticut has budgeted based on a "current services" approach, which:

- Assumes all policies stay in place and are funded in future years in the exact same way.
- Automatically funds every activity or line item previously funded, with increases for inflation, plus new initiatives and program expansions on top of that.

**First, there's an expectation of unchecked spending growth.** We have a budgeting forecast system that projects **approximately five percent growth in expenditures** in an economic environment that only produces approximately two percent growth in revenue.

Second, that leads to a false system of expectations that dictate that, even when line-items go flatfunded or even see increases of millions and millions of dollars, it's fundamentally defined as a "cut".

Several agencies and areas have seen funding dramatically increase over the past several years, but have nonetheless been characterized publicly as areas that have witnessed dramatic cuts.

Another major drawback with the "current services" model is that it consistently overstates future spending. It promises future deficits that do not materialize while creating uncertainty in the economy and a perpetual sense of budget deficits.

The last six current services projections made each November by the Office of Fiscal Analysis, for instance, show a worsening outlook, and some have projected billion-dollar deficits in the out-years. During this exact same period, the state has actually added about \$400 million to its rainy day fund based on actual operating results.

Further, expecting growth of 5% per year, current services budgeting tends to inflate budget needs by capturing new and growing expenses. At the same time, it:

- **Ignores productivity gains** by employees, efficiencies produced through sound management, and prioritization of needs that occurs in efficient organizations.
- Directly conflicts with the well-accepted premise that government expenditures should be **based** on outcomes and effectiveness.

Instead of using "current services", the Governor will move to a model similar to "zero-based budgeting" – one that allows us to budget based on the revenue we have and not on the revenue we wish we could spend.

# **Tackling Our Long-Term Obligations**

One of the issues most deleteriously affecting Connecticut's business climate – and budget – are long-term unfunded pension obligations, which were amassed over decades of inaction. That's why the Governor believes we need to manage these long-term payments in a smart, strategic way.

- SERS and TRS Connecticut's two retirement funds were established in 1939, but not pre-funded until 1971 and 1982, respectively.
- While employees were aging into retirement, state government wasn't saving for the retirement benefits it would one day have to pay.

Since coming into office, Governor Malloy has been dedicated to fully funding pension obligations by making the full ARC payment each year. He also created a new tier for all new state employees (called Tier III) – one that national experts agree is conservative.

- **OVERALL LONG-TERM OBLIGATION:** previous actuarial assumptions have created an unfunded liability of **nearly \$25.7 billion** for SERS and TRS.
- Our two retirement funds one for teachers, one for service employees are funded at 59% and 48% respectively, among the lowest rates in the nation.
- **THE FISCAL CLIFF** Although we currently allocate more than two billion dollars annually to pay for retirement benefits, in 2032 Connecticut will face a fiscal cliff with a single-year payment of nearly \$13 billion to meet our obligations.
- A \$13 billion payment to retirement benefits alone if our budget remained flat would comprise about 65% of all state spending. It is, simply, untenable.
- Businesses are looking at that fiscal cliff for their long-term planning, and for Connecticut to remain competitive over the coming years, we need to act.

That's why, Governor Malloy called for an analysis of the state's two largest pension funds by the nation's foremost experts on the issue. The Governor has endorsed a series of specific recommendations that manage and flatten the payments to ensure they are affordable to taxpayers while guaranteeing that obligations are met.

This session, the Governor has tasked the Office of Policy and Management with convening stakeholders in our two largest retirement funds to evaluate alternative approaches and make recommendations to the Connecticut State Employees Retirement Commission, the Teachers' Retirement Board, and the General Assembly.

# **Defining Core Services**

Connecticut state government does many things – from protecting the public, to educating our kids, to providing robust social services. We fund a wide variety of initiatives to make our state all that it is.

• State government has also entered areas that are less critical – areas that do not comprise our core services. As we face a new budgetary reality, we must be prepared to prioritize.

We know that defining "core services" cannot comprise every single line item.

As such, the Governor's budget:

- Requires that the legislature work with state agencies to identify the core functions of government within each agency.
- Demands that each agency of state government review all activities that it currently supports and prioritize them based on their alignment with those core agency priorities.
- Finally, it mandates that each agency, each contractor, each grantee and each service provider quantify the effectiveness of the state spending they control in furtherance of those core services.

Connecticut must move towards accountability. Efforts that demonstrate better outcomes and lower costs should be supported, while those that are not demonstrated as cost-effective should be discontinued.

### **Holding State Agencies Accountable**

The Governor's fourth principle is simple – agencies should be accountable for their cost-effectiveness.

State agencies should use reporting methods that identify outcomes and resources used in providing core services for the benefit of state legislators and the general public. Transparency is central to achieving our goals.

### And they should be held accountable for that progress.

Efforts in government to measure outcomes and cost-effectiveness are challenging because so many of the funded efforts produce long-term improvements in complex systems.

- **EXAMINING RESULTS:** Connecticut should move towards outcomes-based funding and contracting we should judge allocations based on their effectiveness.
- USING TECHNOLOGY: New-generation technology in many areas of state government will also help us identify outcomes and track costs better, creating new opportunities for successful use of data in managing core state services.
- MANAGERIAL LATITUDE: We need to continue to rely on the creativity and expertise of managers
  in state government to find the best way to deliver core services. When they identify greater costsavings as they fund core services, Commissioners and their agencies should receive the latitude
  they need to accomplish goals.
- TRANSPARENCY: Agency priorities, expenditure information, and outcomes will be posted online on a regular basis
- REDUCING MANDATES: To support commissioners in their efforts to find efficiencies, we must reducing the number of spending mandates placed on them agencies and grant them budgetary flexibility

Transparency and accountability must come hand-in-hand with flexibility. That's why this budget streamlines agency budgets as well as proposes new business intelligence tools for reporting and evaluating programs and service outcomes across state government.

### A New Look for the Budget

To adapt to the new economic reality and shift our budgetary practices, parts of the budget will look different. The changes in philosophical approach will help state agencies make adjustments that deliver effective management, latitude, and government efficiency.

The goal is to protect taxpayer interests.

The current budget structure is focused more on inputs – what is funded – than on outcomes and accountability. Currently, every area of agency operations is appropriated line-item by line-item, with dollar amounts appropriated for personnel, operating expenses, contractual costs, and the like. With this new method, we are able to step back and ask how we live within our means and sustain core priorities.

By consolidating funds within a single operating account, agency commissioners will have more flexibility and responsibility to achieve their missions. When adjustments to those budgets are made, Commissioners will have more latitude to implement them effectively.

To address the shift and to ensure that allocations are delivered clearly and transparently, the Governor supports:

- More widespread use of business intelligence tools available for the state's accounting system
- Enabling agencies to report on the internet, detailed, meaningful, timely data about spending and results for the public to see.

Providing the public with clear information on what money is being spent on, rather than its line item, is critical to shifting our practices and stabilizing our budget. As it stands now, agency activities may be financed across a number of distinct line items, adding to the complexity of the budget-writing process.